

NOTICE OF MEETING AND AGENDA

SPECIAL MEETING OF THE EQUITY: PUBLIC/PRIVATE COMMITTEE OF
THE BOARD OF INVESTMENT

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CALIFORNIA 91101

*8:00 A.M., WEDNESDAY, FEBRUARY 14, 2018

*The Committee may take action on any item on the agenda,
and agenda items may be taken out of order.*

I. CALL TO ORDER

II. APPROVAL OF MINUTES

- A. Approval of the Minutes of the Special Meeting of December 13, 2017.

III. PUBLIC COMMENT

IV. CONSENT ITEMS

- A. None.

V. NON - CONSENT ITEM

- A. None.

VI. REPORT

- A. Private Equity Emerging Managers In-House Review: Evaluation of Management of Private Equity Emerging Manager Program.
Chris Wagner, Principal Investment Officer (Memo dated January 29, 2018))

February 14, 2018

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VII. REPORT ON STAFF ACTION ITEMS

VIII. GOOD OF THE ORDER (For information purposes only)

IX. ADJOURNMENT

*The Board of Investments has adopted a policy permitting any member of the Board to attend a standing committee meeting open to the public. Members of the Board of Investments who are not members of the Committee may attend and participate in a meeting of a Committee but may not vote on any matter discussed at the meeting. The only action the Committee may take at the meeting is approval of a recommendation to take further action at a subsequent meeting of the Board.

The Chair of the Board of Investments may appoint alternate voting members if absences result in less than 3 voting members.

Documents subject to public disclosure that relate to an agenda item for an open session of the Board of Investments that are distributed to members of the Board of Investments less than 72 hours prior to the meeting will be available for public inspection at the time they are distributed to a majority of the Board of Investments Members at LACERA's offices at 300 N. Lake Avenue, Suite 820, Pasadena, CA 91101, during normal business hours of 9:00 a.m. to 5:00 p.m. Monday through Friday.

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MINUTES OF THE SPECIAL MEETING OF THE EQUITY: PUBLIC/PRIVATE
COMMITTEE OF THE BOARD OF INVESTMENTS*

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CA 91101

WEDNESDAY, DECEMBER 13, 2017

PRESENT: Herman Santos, Chair
Valerie Villarreal, Vice Chair
Diane Sandoval
Shawn Kehoe

ABSENT: Wayne Moore, Alternate

MEMBERS AT LARGE: Joseph Kelly

David Green

STAFF, ADVISORS, PARTICIPANTS

Jonathan Grabel, Chief Investment Officer

Chris Wagner, Principal Investment Officer

David Simpson, Investment Officer

Meketa Investment Group

Leandro Festino, Managing Principal, Meketa Group

Tim Filla, Vice President, Meketa Group

StepStone Group, LP

Jose Fernandez, Partner

I. CALL TO ORDER

The Meeting was called to order by Chair Santos at 8:07 p.m., in the Board Room of Gateway Plaza.

II. APPROVAL OF MINUTES

A. Approval of the Minutes of the Special Meeting of August 9, 2017. Mr. Kehoe made a motion, seconded by Mr. Green, to approve the minutes of

the special meeting. The motion passed unanimously.

III. PUBLIC COMMENT

There were no requests from the public to speak.

IV. CONSENT ITEMS

There were no Items.

V. NON-CONSENT

- A. Recommendation as submitted by Christopher Wagner, Principal Investment Officer and David Simpson, Investment Officer: That the Committee approve/advance the 2018 Private Equity Objectives, Policies & Procedures. (Memo dated November 22, 2017)

Mr. Christopher Wagner and Mr. Simpson were present and answered questions from the Committee.

Ms. Villarreal made a motion, seconded by Mr. Kelly to approve/advance the recommendation. The motion passed unanimously.

- B. Recommendation as submitted by Christopher Wagner, Principal Investment Officer and David Simpson, Investment Officer: That the Committee approve/advance the 2018 Private Equity Investment Plan. (Memo dated November 22, 2017)

Mr. Wagner, and Mr. Simpson were present to and answered questions from the Committee.

Ms. Sandoval made a motion, seconded by Mr. Santos to approve/advance the recommendation. The motion passed unanimously.

- C. Recommendation as submitted by Christopher Wagner, Principal Investment Officer: That the Committee approve/advance the Secondary Advisor(s) Request for Proposal Process. (Memo dated December 4, 2017)

Mr. Wagner was present to answer questions from the Committee.

Ms. Santos made a motion seconded by Ms. Sandoval to approve/advance the recommendation. The motion passed unanimously.

VI . REPORTS

A. Co-Investment Program Update

Received and filed

B. Evaluation of Management of Private Equity Emerging Manager Program

Received and filed

VII. REPORT OF STAFF ACTION ITEMS

A. None.

VIII. GOOD OF THE ORDER

(For information purposes only)

There were no comments.


IX. ADJOURNMENT

There being no further business to come before the Board, the meeting was adjourned
at 8:55 a.m.

*The Board of Investments has adopted a policy permitting any member of the Board to attend a standing committee meeting open to the public. In the event five (5) or more members of the Board of Investments (including members appointed to the Committee) are in attendance, the meeting shall constitute a joint meeting of the Committee and the Board of Investments.

January 29, 2018

TO: Equity: Public/Private Committee
Herman Santos, Chair
Wayne Moore, Vice Chair
Gina Sanchez
Shawn R. Kehoe
David Green, Alternate

FROM: Christopher J. Wagner 
Principal Investment Officer - Private Equity

FOR: February 14, 2018 Equity: Private/Public Committee Meeting

SUBJECT: **EVALUATION OF MANAGEMENT OF PRIVATE EQUITY EMERGING
MANAGER PROGRAM**

DISCUSSION

Evaluate the costs of continuing to outsource management of the LACERA Private Equity Emerging Manager Program (“EM Program”) versus an in-house management model.

BACKGROUND

At the November 2017 Board of Investments meeting, the Board requested it be given the opportunity to evaluate options to transition the Private Equity Emerging Manager Program to an “in-house” management model, versus engaging a third-party, separate account manager as is the current practice.

Staff committed to evaluating an in-house option for the LACERA BOI Equity Committee to discuss and review in 2018; this evaluation and summary findings are included in **Attachment**.

NOTED AND REVIEWED:



Jonathan Grabel
Chief Investment Officer

LACERA Private Equity Emerging Manager Program Implementation Model Analysis

February 14, 2018

**LOS ANGELES COUNTY EMPLOYEES
RETIREMENT ASSOCIATION**

Outline of Topics Covered

- Background and History: Private Equity Emerging Manager Program (“EM Program”)
- 2018 Updates and Findings in response to Board requests
- Data Supporting Implementation Model Analysis

EM Program History

2001 LACERA described its Private Equity Emerging Manager Program in the Emerging Manager Policy, Section M of the LACERA Investment Policy Statement¹

Private Equity

The objective of the private equity Emerging Manager Program is to diversify the portfolio by partnering with investment managers that are not part of the core program, while generating performance results consistent with LACERA's private equity class return expectation—the Russell 3000 plus 300 to 500 basis points. The Emerging Manager Program will provide LACERA the ability to invest in smaller, lesser-known firms and in some cases first time funds.

A “manager-of-manager separate account” strategy was selected as the most effective way to implement LACERA's private equity Emerging Manager Policy because of the resources required to manage this program. The following defines the manager-of-manager's (“Manager”)

2008

LACERA outsourced its EM Program, hiring JPMorgan to manage a dedicated separate account; JPMorgan managed the LACERA EM Program through 2017, funded by three separate Board decisions

2017

LACERA ran a search to identify qualified candidates to manage its EM Program; additional objectives² were incorporated, though the preferred implementation strategy stayed the same

- Key Program Objectives: (1) access the small fund universe globally; and (2) source top quality managers for LACERA's core private equity portfolio as they graduate from "emerging" manager status.
- Additional Program Objective: The Equity Committee asked staff to add the goal of achieving terms favorable to LACERA (economic and governance-related) when investing in emerging manager funds. Accordingly, negotiating favorable terms has been named as a Key Program Objective.

2018

The Board extended the JPMorgan relationship by selecting them to manage a \$300 million separate account at the conclusion of the 2017 search. The Board also requested a cost-benefit analysis on EM Program implementation.

Sources: (1) LACERA Investment Policy Statement.
(2) February 2017 Equity Committee memo, dated January 27, 2017: Private Equity Emerging Manager Program Fund-of-Funds Separate Account Manager Search Proposed Minimum Qualifications and Investment Criteria.

2018 Update and Findings

Fourth Separate Account managed by JPMorgan

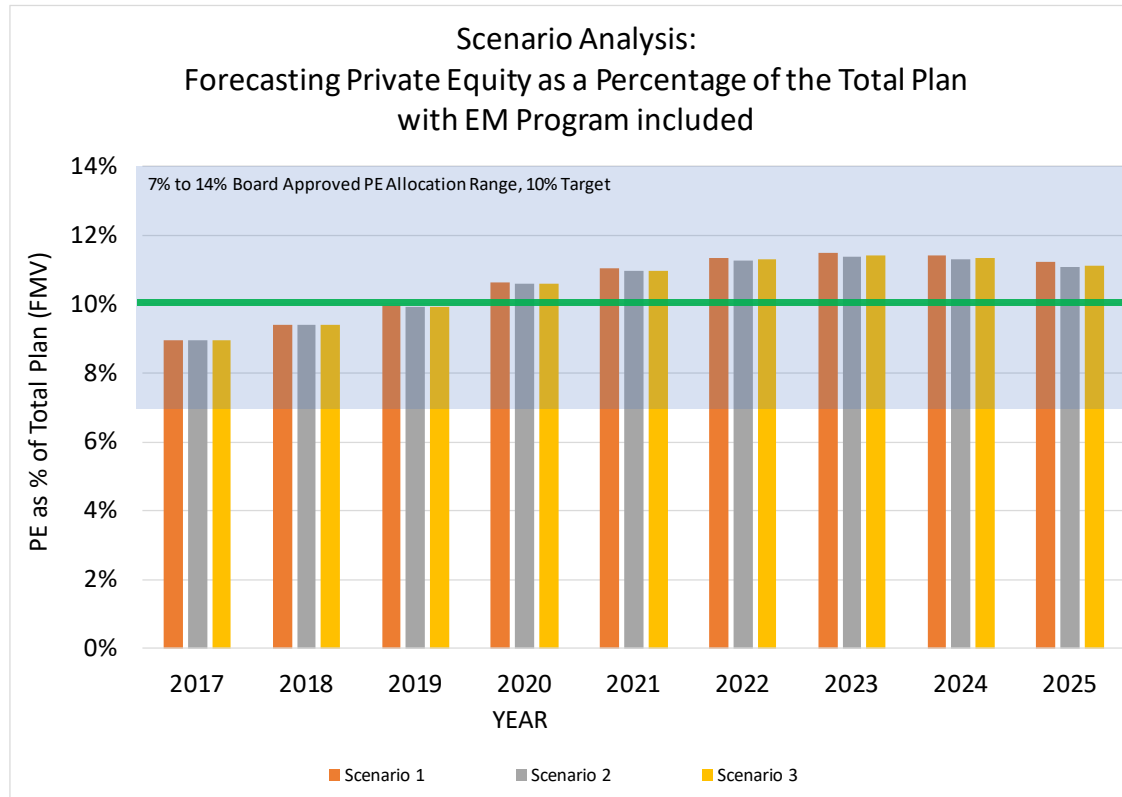
- Expected to start investing in second half of 2018
- Capacity remains in third separate account: 62% committed and reserved as of January 2018
- Program design, legal and fee negotiations for fourth account currently underway

Cost-Benefit Analysis on Implementation Models

- Returns generated by the EM Program are additive to, though do not materially drive, investment results for the private equity (“PE”) program and total fund. All forecasted EM Program investment results sustain the current Board-approved private equity allocation range of 7-14%
- On a dollar basis, and assuming a 2x gross return on invested capital, external management is approximately 1.6x more expensive than the anticipated cost of building in-house capability to manage the LACERA EM Program
- 73% of anticipated fees to be earned by an external manager is “at risk income” in the form of carried interest, which the manager only earns above a defined performance hurdle rate
- If LACERA opted to build in-house capability required to prudently manage a primary fund-of-funds emerging manager program deploying \$100 million annually, the equivalent of a 22% increase to its approved 2017-2018 Investment Division budget would be required

EM Program Impact to PE Program

- The EM Program has a modest impact on PE allocation as a percentage of the Total Fund
- A scenario analysis (graph below) shows highly similar outcomes to PE allocation at a range of EM Program investment returns



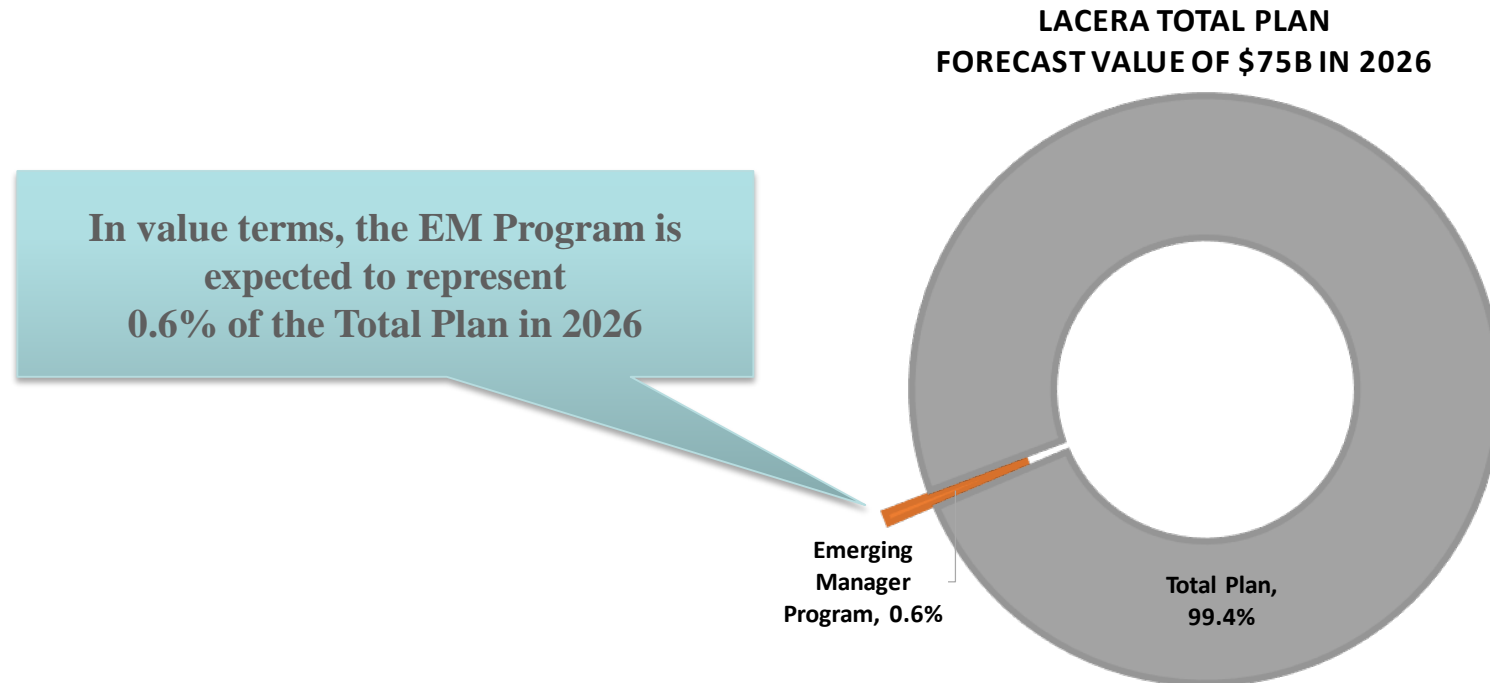
All forecasted scenarios sustain a PE allocation within the Board-approved target range of 7-14%

Cases:

- Scenario 1 = core program + \$100m annual deployment to EM primary funds, using EM program net since-inception primary fund IRR (18.7%)
- Scenario 2 = core program + \$100m annual deployment to EM primary funds; using general consultant expected return for PE (9.3%)
- Scenario 3 = core program + \$100m annual deployment to EM primary funds; using PE advisor expected return for buyout/venture capital (12.6%)

EM Program Impact to Total Fund

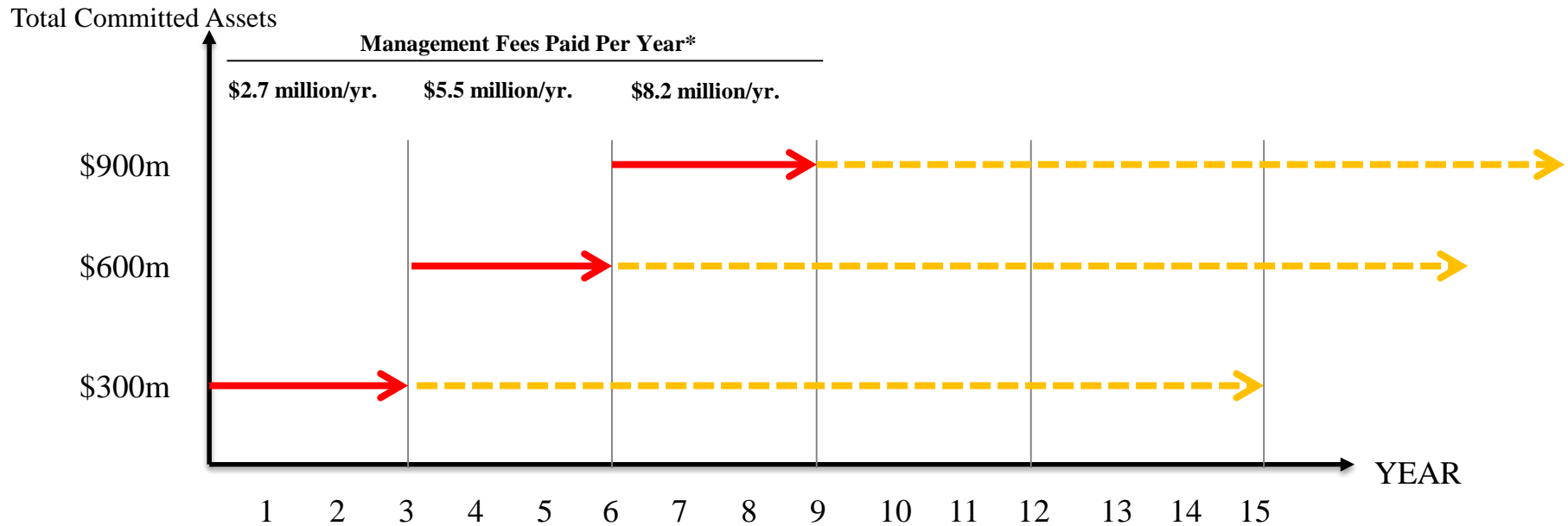
- **Within the context of the Total Fund, the EM Program is relatively small; therefore, returns achieved by it are additive, though not a material driver of overall results**



- **The EM Program (annual deployment pace of ~\$100 million) is sized to target investment in 5-7 small funds per year to:**
 - Limit manager proliferation (for portfolio construction), while
 - Maintaining diversification (for risk management), and
 - Requiring a high bar for fund selection

EM Program Costs (External)

- **Separate accounts are typically structured with investment periods (when capital is invested) followed by lock-up periods, when a portfolio is monitored and harvested**
- **To invest \$100 million per year through an external manager, separate accounts would hypothetically be renewed every three years, stacking the annual fee load**
- **During market downturns, private equity fund lives tend to elongate, thereby creating the potential for necessary term (and fee) extensions on separate account vehicles**



→ investment period

- - - - - → lock-up period

*Management fees based on expected full cost (carry + management fees) of (three) \$300 million separate accounts allocated across 15 year terms at 2.0x gross return, facilitating nine years of investment of \$100 million annually.

EM Program Costs (Internal)

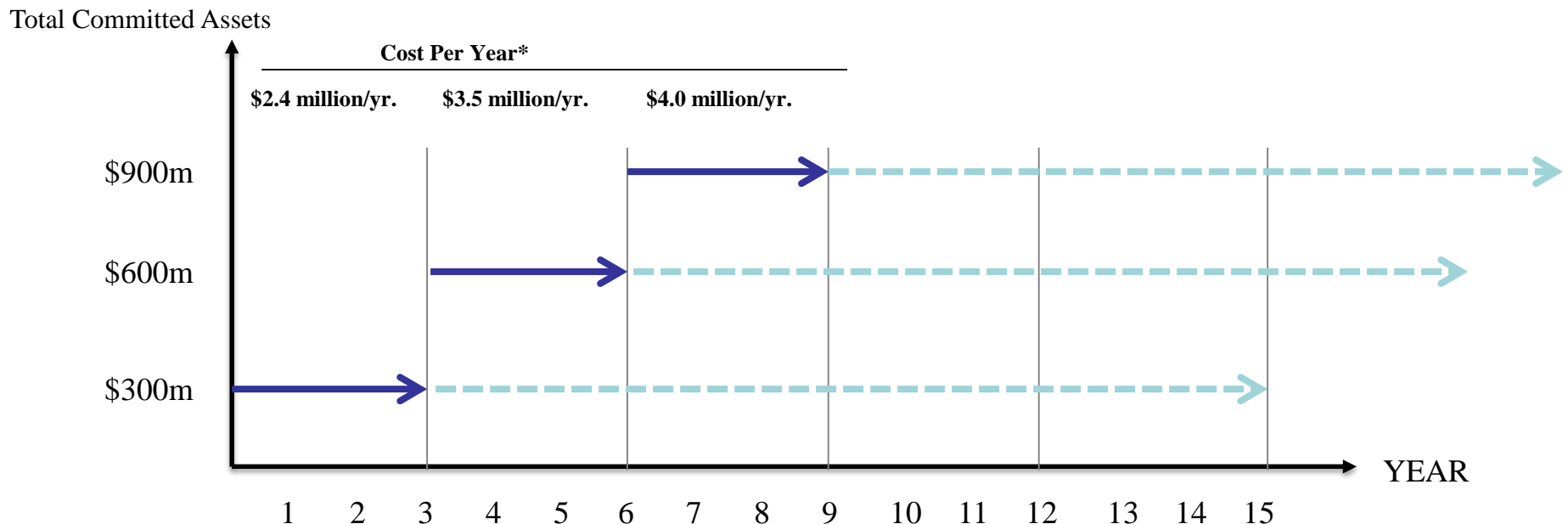
- **Building appropriate in-house capability would represent an estimated \$2.3 million increase costs to LACERA (in year 1), or 22% of the Investment Division’s approved 2017-2018 budget***
- **The increased expenditure would support an incremental \$100 million in annual capital deployment**

Category	Expected Additions	Year 1 Incremental Cost
Personnel	+ 2 investment professionals, 1 with turnaround expertise + 2 monitoring professionals + 1 legal professional (not reflected in Investment Division budget) + 1 accounting professional (not reflected in Investment Division budget) <i>Assumes:</i> <ul style="list-style-type: none"> - <i>Investment pace of 5-7 funds per year</i> - <i>Higher time requirement versus core program due to inefficiency of market segment (emerging managers)</i> - <i>Increased number of funds to monitor</i> - <i>Not all funds will perform well; historically, the EM Program has been managed through a “bull market” if the cycle turns and/or managers underperform, resources should be in place to monitor and guide a favorable outcome for LACERA</i> 	\$800,000 Investment Division \$400,000 Legal and Accounting Divisions
Travel	<i>Assumes: travel for investment and operational due diligence, fund monitoring, annual meeting attendance, industry events</i>	\$100,000
Third-Party Advisers	<i>Assumes: increased cost of private equity advisor, legal advisors, operational and industry due diligence service providers, custody bank</i>	\$1,000,000
TOTAL ESTIMATED ANNUAL INTERNAL MANAGEMENT COST		\$2.3 million

*22% represents the full Year 1 Incremental Cost; only \$1.9 million would be attributable to the Investment Division, assuming \$400 thousand would be borne by the Legal and Accounting Divisions. Evaluating Investment Division costs only, the increase to the 2017-2018 divisional budget would be 19%.

EM Program Costs (Internal)

- For comparison purposes, the anticipated expense of constructing an internal team focused on the EM Program has been modeled to mimic that of a third-party manager



—→ investment period

- - - - -→ lock-up period

*Displays the estimated annual average for every period. Includes expected expenses and fees required to create internal infrastructure (personnel, travel, operational costs, advisory fees) that scale with the volume of committed assets.

Cost Comparison

The Costs below assume:

1. \$100 million invested annually (for 9 years) into primary funds
2. A gross multiple of invested capital of 2.0x
3. Three 15 year investment programs (total duration of 21 years)

TOTAL EXPECTED COST COMPARISON:

Full External Cost <i>Includes carried interest and management fee</i>	\$123 million	The expected cost of building internal infrastructure to manage the EM Program is compared to the expected “full” cost of an outsourced manager, which includes contingent fees or “carried interest” earned only above a defined hurdle rate
Full Internal Cost	\$76 million	
Difference	\$47 million additional cost with external management	

FIXED COST COMPARISON:

External Management Fee <i>excludes carried interest</i>	\$33 million	This analysis compares known fees (fixed costs), that would be paid irrespective of investment performance
Internal Cost	\$76 million	
Difference	(\$43) million savings with external management	